# ALBERTA HERITAGE SAVINGS TRUST FUND
# ANNUAL REPORT
# 2003

FOR THE YEAR ENDED MARCH 31, 2003

Heritage Fund

Alberta
REVENUE

103-05225/

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# Minister of Revenue's Report to Albertans on the Alberta Heritage Savings Trust Fund

Fiscal 2002-03 marked the 27th year of the Alberta Heritage Savings Trust Fund. The Fund is a source of pride to all Albertans. Over the past 27 years, the Fund has generated approximately $25 billion dollars in investment income. The Fund's income is transferred to the Province's main operating account, the General Revenue Fund, where it is used for Albertans' priorities such as health care, education, roads, tax reductions and debt repayment.

The Heritage Fund has investments around the world including Canada, the United States, Europe, Australia, Asia and the Far East. The Fund is comprised of investments in bonds, mortgages, public and private equities, real estate, derivative products and absolute return strategies.

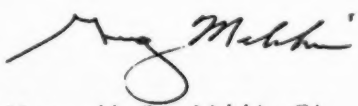
An atmosphere of uncertainty prevailed in public equity markets throughout 2002-03. Few investors escaped the effects of significant declines in stock values. Tensions in the Middle East, fears of a slowing world economy, unwinding of excess capacity in the technology sector and concerns over corporate governance all contributed to a general loss of investor confidence in the stock market. The decline in the value of the Fund's equity holdings was partially offset by solid performance from the Fund's bond, mortgage and real estate portfolios.

As of March 31, 2003, the Heritage Fund closed out the year with a fair value of $11.1 billion, a decrease of $1.3 billion from the previous year. On a fair value basis, the Fund recorded a negative rate of return of 11.0% over the year and a positive annualized return of 0.3% over four years.

On a cost basis, after writedowns of equity investments, the value of the Heritage Fund at March 31, 2003 was $11.4 billion compared to $12.3 billion one year earlier. The Fund's investment loss for the year was $894 million; however, over the previous four years the Fund had contributed over $3 billion of income to pay for priority programs for Albertans. A return to positive income is forecast for 2003-04.

The key to achieving long-term, sustainable performance is to maintain a prudent, diversified portfolio, long-term focus, and investment discipline. As a result, the policy asset mix for 2003-06 increases investments in real estate, private equities and absolute return strategies and reduces modestly the Fund's exposure to public equities. The performance of the fund is assessed over the long term since volatility in markets can produce significant fluctuations in performance from year to year. Management is cautiously optimistic that stock markets will rebound over the next year.

Albertans feel strongly about the Alberta Heritage Savings Trust Fund. In the fall 2002 survey, *"Looking Forward: Planning for the Future With the Alberta Heritage Savings Trust Fund"*, the majority of the 77,000 respondents favored a strong, healthy Heritage Fund that continues as an endowment. Albertans look forward to the future with the Heritage Fund further strengthened to ensure the Fund continues to benefit Albertans, just like it has over the last 27 years.



Honourable Greg Melchin, CA
Minister of Revenue

# Fund Governance

- The Heritage Fund was established in 1976 and operates under the authority of the *Alberta Heritage Savings Trust Fund Act*. On January 1, 1997, a new *Act* came into effect that sets out a revised investment framework for the Fund.

- The Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan and annual report of the Fund. The Standing Committee has representation from the major parties of the legislature. The Standing Committee receives regular reports on the performance of the Fund and conducts public meetings on an annual basis in different locations in the Province. The purpose of these meetings is to update Albertans on the management of the Fund and to solicit input from Albertans.

- The Ministry of Revenue is responsible for the Fund and its investments. The Minister of Revenue is required to report on the performance of the Fund quarterly within 60 days of the end of the quarter and make public the annual report within 90 days of the end of the fiscal year.

- The business plan of the Heritage Fund is published as part of the provincial budget and the income of the Fund is consolidated into the revenue of the Province.

- An Investment Operations Committee (IOC) was established to add private sector financial and business oversight of the Fund's investment policies and operation. The IOC is chaired by the Deputy Minister of Revenue and consists of private sector members. The Committee reviews and makes recommendations with respect to the business plan, annual report and investment policy statements for the Fund. The Committee meets at least quarterly to review performance and fund management.

- The investment portfolio of the Heritage Fund is managed by a group of highly qualified and experienced professionals in Alberta Revenue's Investment Management Division (IMD). External managers (specialized private sector investment managers) are used to manage specific investment mandates.

# Business Plan

## PURPOSE

The business plan for the Heritage Fund describes the mission, goals, investment objectives, and how the Fund's performance will be measured. The business plan is reviewed annually and is published as part of the Provincial budget. The Investment Operations Committee (IOC) reviews and makes recommendations regarding the business plan and the investment policies for the Fund. The business plan is then reviewed and approved by the Minister of Revenue, the Treasury Board and the Legislature's Standing Committee on the Alberta Heritage Savings Trust Fund.

## MISSION

The statutory mission of the Fund is:

> **"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."**

## GOALS

The three goals of the Fund, as outlined in the 2002-05 business plan, remain as follows:

1. Earn income to support the Government's consolidated fiscal plan.
2. Make investments to maximize long-term financial returns. The Heritage Fund is expected to generate an annualized real rate of return of 5.0% at an acceptable level of risk over a four-year period.
3. Improve Albertans' understanding and the transparency of the Heritage Fund.

## INVESTMENT OBJECTIVE

The investment objective of the Fund is to optimize long- term financial returns subject to an acceptable level of risk. By legislation, Alberta Revenue operates under the "Prudent Person Rule". This assigns to the investment manager the responsibility to restrict investments to assets that would be approved by a prudent person. Investment funds with long-term investment horizons, and an objective to optimize long-term returns, invest a significant amount of their assets in equities since equities have historically provided investors with higher total returns (dividends and capital gains) than interest bearing securities. The Heritage Fund follows a similar strategy to achieve higher financial returns. However, as witnessed in recent years, this can result in volatility in income.

## PERFORMANCE MEASURES

The Heritage Fund business plan outlines various performance measures and benchmarks which are reviewed annually to determine ongoing suitability.

The 2002-05 business plan incorporated the following major changes:

- Increased investments in private equities, absolute return strategies and real estate.
- Reduced investments in public equities to accommodate the increase in private equities, real estate and absolute return strategies.

The following table summarizes the 2002-05 business plan performance measures, including the long-term investment policy weights and benchmark return indices by asset class.

| ASSET CLASS | Policy Allocation 2002-03 | 2001-02 | Benchmark Return Index |
|---|---|---|---|
| **Fixed income:** | | | |
| Money market | 2.0% | 2.0% | Scotia Captial 91-Day T-Bill |
| Bonds | 33.0% | 33.0% | Scotia Captial Universe Bond Index |
| | **35.0%** | **35.0%** | |
| **Public equities** | | | |
| Canadian | 20.0% | 23.0% | Toronto Stock Exchange (S&P/TSX) Index |
| United States | 15.0% | 17.5% | Standard & Poor's (S&P) 500 Index |
| Non-north American | 15.0% | 17.5% | Morgan Stanley Capital International (MSCI) EAFE Index |
| | **50.0%** | **58.0%** | |
| **Private equities** | **2.0%** | - | Consumer Price Index (CPI) plus 8% |
| **Absolute Return Strategies** | **3.0%** | - | Consumer Price Index (CPI) plus 6% |
| **Real Estate** | **10.0%** | **7.0%** | Consumer Price Index (CPI) plus 5% |
| | **100.0%** | **100.0%** | |

# The Year in Review

## YEAR IN REVIEW

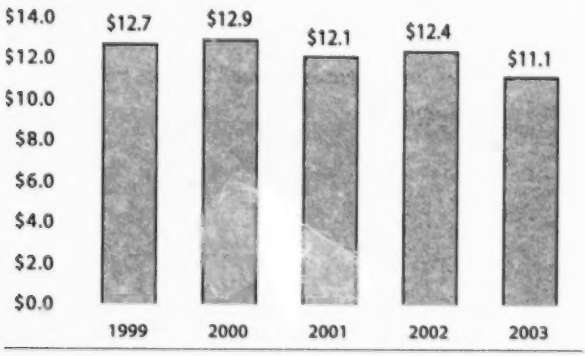
The first and second quarters of 2002-03 saw great uncertainty regarding the future path of the world economy. World equity markets continued to experience significant declines in stock values. The information technology sector led the decline in value of share prices. The decline in the equity markets was attributed to a number of factors including the slowing world economy, tensions in the Middle East, corporate governance concerns, unwinding of excess capacity in the technology sector and the general loss of investor confidence. Investor confidence stabilized in the third quarter as the outlook for corporate earnings improved and reports of accounting irregularities subsided. In the fourth quarter, the beginning of the US led war with Iraq resulted in greater uncertainty in the stock market and a corresponding decline in share prices.

| | Actual Return (%) | Change in Fair Value ($ millions) |
|---|---|---|
| First Quarter | -4.8% | $ (582) |
| Second Quarter | -6.5% | (762) |
| Third Quarter | 4.8% | 522 |
| Fourth Quarter | -4.5% | (517) |
| 2002-03 Year | -11.0% | $ (1,339) |

At March 31, 2003, the fair value of the Heritage Fund stood at $11.1 billion, down $1.3 billion from $12.4 billion at the beginning of the year.

**HERITAGE FUND - FAIR VALUE**

As at March 31(billions)




## INVESTMENT INCOME

The Fund recorded a net loss of $894 million during fiscal year 2002-03. Over the year, income of $286 million from investments in bonds, notes, short term paper, $39 million from real estate investments and $5 million from absolute return strategies was offset by losses of $1,224 million from investments in equity markets. Realized capital losses from declining world stock markets, primarily in the information technology and telecommunication services sectors, contributed to the net loss for the year.

**INVESTMENT INCOME (LOSS)**

(millions)

| | Fixed Income | Equity Income | Real Estate | Absolute Return Strategies | Total |
|---|---|---|---|---|---|
| 02-03 | $286 | $ (1,224) | $ 39 | $ 5 | $ (894) |
| 01-02 | 444 | (276) | 38 | - | 206 |
| 00-01 | 532 | 157 | 17 | - | 706 |
| 99-00 | 610 | 539 | 20 | - | 1,169 |
| 98-99 | 769 | 159 | 4 | - | 932 |
| | $2,641 | ( $ 645) | $ 118 | $ 5 | $ 2,119 |

## INVESTMENT VALUATION

Investments and investment income are recorded on the financial statements of the Heritage Fund at cost in accordance with government accounting policies. The fair value of the Fund and its investments are provided for information purposes. Management uses fair value to assess the investment performance of the fund against market-based benchmarks.

The Fund's policy is to write down the cost of those securities where the decline in value below cost is not considered temporary. On a quarterly basis, management reviews the Fund's investment portfolio to identify those securities where the fair value has declined significantly below cost. The Fund's net loss of $894 million for the year includes write downs of $669 million, primarily against information technology stocks.

## CHANGE IN NET ASSETS

The Heritage Fund accounts for its investments on a cost basis. Investment income on a cost basis excludes unrealized gains and losses. Investment income on a fair value basis includes unrealized gains and losses. The investment loss on a fair value basis for fiscal year 2002-03 is $1,339 million.

### CHANGES IN NET ASSETS

(millions)

| | 2003 | 2002 |
|---|---|---|
| Fair value, beginning of year | $12,414 | $12,124 |
| Investment income (loss), cost basis* | (894) | 206 |
| Change in unrealized appreciation (depreciation) in value of investments | (445) | 290 |
| Investment income (loss), fair value basis | (1,339) | 496 |
| Transfers to the General Revenue Fund** | - | (206) |
| Fair value, end of year*** | $11,075 | $12,414 |

* includes interest, dividends, realized gains and losses, derivative income and administration expenses

** see financial statements (Note 6)

*** includes investments of $ 11,059 million and net current assets of $ 16 million.

## INVESTMENT ASSET MIX

The investment strategy is to invest in a diversified portfolio to optimize long-term returns at an acceptable level of risk. The policy asset allocation in the Fund's 2002-05 business plan was as follows:

### ASSET MIX POLICY

Percent of Fair Value

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | Policy Target | Actual | Policy Target | Actual |
| ASSET CLASS | | | | |
| **Fixed income** | 35.0 | 35.8 | 35.0 | 43.0 |
| **Equities** | | | | |
| Public equities: | | | | |
| Canadian | 20.0 | 21.4 | 23.0 | 20.1 |
| United States | 15.0 | 15.8 | 17.5 | 15.8 |
| Non-north American | 15.0 | 15.7 | 17.5 | 15.8 |
| | 50.0 | 52.9 | 58.0 | 51.7 |
| **Private equities** | 2.0 | 0.8 | - | 0.6 |
| **Absolute Return Strategies** | 3.0 | 2.6 | - | - |
| **Real Estate** | 10.0 | 7.9 | 7.0 | 4.7 |
| | 100.0 | 100.0 | 100.0 | 100.0 |

For the 2002-03 fiscal year, the policy asset mix for fixed income securities remains the same as the previous year at 35%. The policy mix for public equity investments decreases from 58% to 50% while real estate investments were targeted to increase from 7% to 10%, private equities and absolute return strategies increased to 2.0% and 3.0% respectively.

The actual investment mix changed over the past year. Fixed income securities declined from 43.0% to 35.8%. Public equity investments increased from from 51.7% to 52.9%. Actual public equities exceeded the target policy by 2.9% as a result of fewer than expected opportunities for investments in private equities, real estate and absolute return strategies. Nevertheless, real estate investments increased from 4.7% to 7.9 % of the Fund's total investment portfolio. A new investment asset class called Absolute Return Strategies (see Glossary) was initiated in September 2002 and comprises 2.6% of the Fund's investment portfolio. Private equity investments increased from 0.6% to 0.8%.

## TRANSFERS TO THE GENERAL REVENUE FUND

The Fund's net income is transferred to the Province's main operating fund, the General Revenue Fund (GRF), and used for Albertans' priorities like health care, education, roads, tax reductions and debt repayment. Changes in unrealized gains and losses are not included in amounts transferred to the General Revenue Fund. As a result of the Fund's net loss of $894 million for the year, no transfers were made to the General Revenue Fund. The net loss reduces the equity of the Heritage Fund.

The Government of Alberta financial statements are prepared on a consolidated basis which eliminates the income the Heritage Fund earns from Alberta Government and Provincial Corporation securities totaling $18 million for the year ending March 31, 2003. On a consolidated basis the Heritage Fund loss was $912 million.

# Performance Measurement

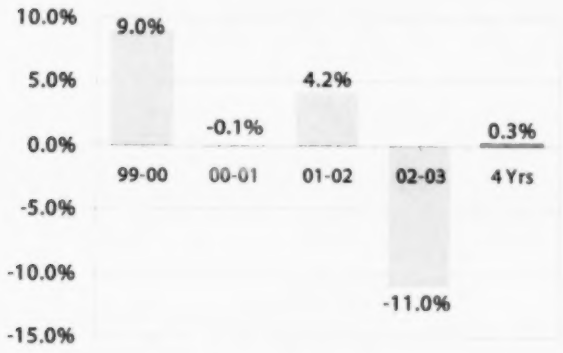
## HERITAGE FUND RATE OF RETURN

The Heritage Fund posted an overall negative rate of return of 11.0% this year. Negative returns from Canadian, US, and non-North American public equity investments were partially offset by positive returns from the fixed income investments, real estate and absolute return strategies.

Over the past four-year period, the fund generated an annualized return of 0.3%.

### HERITAGE FUND ANNUAL RETURNS

At Fair Value (percent)

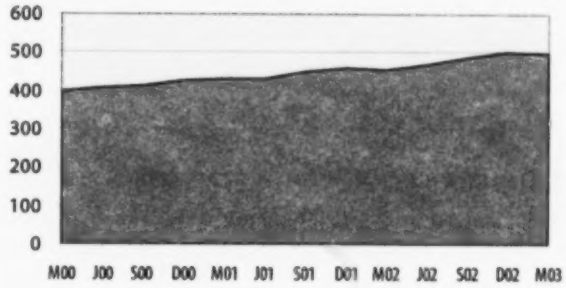



The performance of Heritage Fund investments is measured against various market-based indices. Value added by investment management is accomplished through asset mix decisions and security selection. The following sections describe the performance of the Fund's major asset classes in relation to their benchmarks.

## FIXED INCOME INVESTMENTS

The Canadian bond market performed well this year reflecting the deep bear market in equities, concerns about the US economic recovery and problems in the Middle East. The Scotia Capital (SC) Universe Bond Index measures the performance of marketable Canadian bonds with terms to maturity of more than one year. Over the past year, the SC Universe Bond Index increased by 9.2% while the short term SC 91-Day T-Bill Index increased by 2.7%.

### SC UNIVERSE BOND INDEX




| LT Fixed income | Actual Return % | SC Universe Bond Index % | Over (Under) | |
|---|---|---|---|---|
| One year | 9.5 | 9.2 | 30 | bps |
| Four Years (annualized) | 6.6 | 6.0 | 60 | bps |

| ST Fixed Income | Actual Return % | Benchmark SC 91-Day T-Bill Index % | Over (Under) | |
|---|---|---|---|---|
| One year | 3.0 | 2.7 | 30 | bps |
| Four Years (annualized) | 4.5 | 4.2 | 30 | bps |

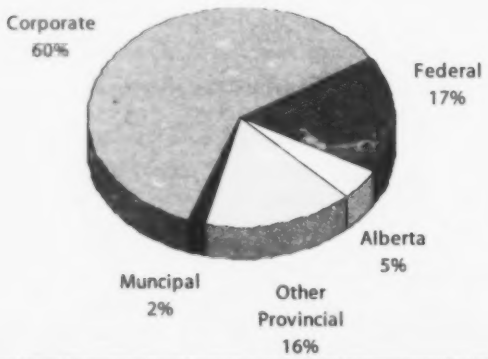
The Fund's actual rate of return over the year from Canadian bonds was 9.5%, 30 basis points better than the benchmark SC Universe Bond Index. The outperformance was primarily due to overweight in high quality corporate bonds relative to government bonds and the strong performance of private mortgages.

The Fund's return from short-term securities was 3.0% or 30 basis points better than the benchmark SC 91-Day T-Bill Index. Over the year, investments in bonds, notes, short term paper, provincial corporation debentures and loans declined from 43.0% to 35.8% of total investments. Fixed income securities now total $4.0 billion down from $5.4 billion the previous year.

The Fund's Canadian fixed-income portfolio is comprised of diversified holdings in corporate, federal, provincial and municipal bonds, notes and short-term paper.

### SUMMARY OF FIXED INCOME HOLDINGS

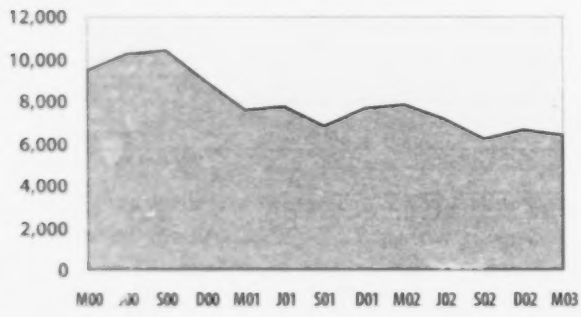
(issued and guaranteed by)




## CANADIAN EQUITY INVESTMENTS

The Canadian stock market struggled through a very volatile year as investors worried about a lackluster economic recovery, geopolitical risks and highly publicized corporate scandals in the US. The S&P/TSX Composite Index which measures the performance of Canada's top companies in ten industrial sectors, decreased by 17.6% for the year ending March 31, 2003.

### S&P / TSX




| Canadian Public Equities | Actual Return % | Benchmark S&P/TSX Index % | Over (Under) |
|---|---|---|---|
| One year | (16.6) | (17.6) | 100 bps |
| Four Years (annualized) | 0.1 | 0.6 | (50) bps |

The Heritage Fund's Canadian equity portfolio is held in various investment pools which are managed by internal and external managers. Over the year, the Fund's actual return from Canadian equities was negative 16.6%. The fund outperformed the S&P/TSX benchmark by 100 bps due to a higher allocation of small capitalization securities. Over four years, the fund's return from Canadian equities was 50 basis points less than the benchmark S&P/TSX due to an overweight position in growth oriented securities.

At March 31, 2003, investments in Canadian public equities totaled $2.4 billion or 21.4% of the Heritage Fund investment portfolio compared to $2.5 billion or 20.1% a year earlier.

### TOP TEN HOLDINGS IN THE CANADIAN EQUITY PORTFOLIO

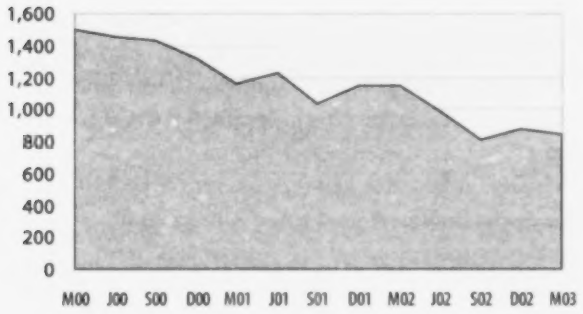
March 31, 2003

| Company | % |
|---|---|
| Royal Bank of Canada | 6.0% |
| Bank of Nova Scotia | 4.5% |
| Encana Corp | 3.7% |
| Toronto Dominion Bank | 3.5% |
| BCE Inc. | 3.4% |
| Bank of Montreal | 3.4% |
| Sun Life Financial Services | 3.3% |
| Petro Canada | 2.8% |
| Manulife Financial Corp. | 2.4% |
| Canadian Imperial Bank of Commerce | 2.3% |

## UNITED STATES EQUITY INVESTMENTS

The United States equity market closed out the fiscal year in a bear market due to a combination of corporate scandals, a weak economy and poor profits. Aggressive action to improve corporate governance and interest rate cuts by the US Federal Reserve restored investor confidence in the fall. But the stock recovery was short lived due to tensions in the Middle East. The Standard & Poor's 500 Index (S&P 500) which measures the performance of the top 500 American companies, decreased by 30.7% over the year in Canadian dollars.

**S&P 500**




The Fund's actual rate of return over the year from US equities was negative 30.6%. The negative impact of the strengthening Canadian dollar was partially offset through currency hedges. Over four years, the Fund's US equity portfolio returned a negative 9.2%. The fund outperformed the S&P 500 benchmark by 10 bps on both the short term and long term from an overweight position in small cap securities.

| US Public Equities | Actual Return % | Benchmark S&P 500 Index % | Over (Under) |
|---|---|---|---|
| One year | (30.6) | (30.7) | 10 bps |
| Four Years (annualized) | (9.2) | (9.3) | 10 bps |

At March 31, 2003, investments in US equities totaled 15.8% or $1.8 billion of the Heritage Fund investment portfolio compared to 15.8% or $2.0 billion a year earlier.

### TOP TEN HOLDINGS IN THE U.S. EQUITY HOLDINGS

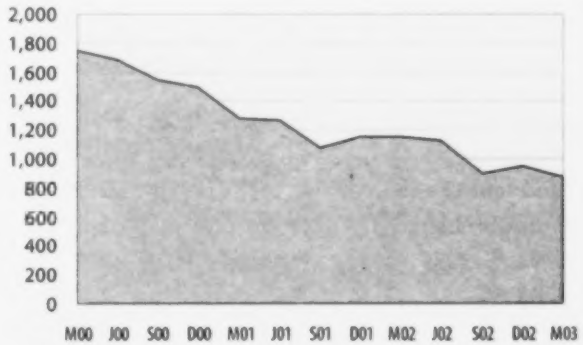
March 31, 2003

| Company | % |
|---|---|
| Microsoft Inc. | 2.8% |
| Pfizer Inc. | 2.4% |
| Citigroup Inc. | 2.1% |
| Exxon Mobil Corp. | 2.1% |
| Johnson & Johnson | 2.0% |
| General Electric Co. | 1.9% |
| Pepsico | 1.5% |
| American International Group Inc. | 1.4% |
| Wal-Mart Stores | 1.4% |
| Viacom Inc | 1.3% |

## NON-NORTH AMERICAN EQUITY INVESTMENTS

The non-North American equity market declined for the 3rd consecutive year. The Morgan Stanley Capital International Index for Europe, Australasia and the Far East, MSCI EAFE Index, measures the performance of approximately 1000 companies on 21 stock exchanges around the world. The index decreased by 29.3% over the year in Canadian Dollars.

**MSCI EAFE**




| EAFE Public Equities | Actual Return % | Benchmark MSCI EAFE Index % | Over (Under) |
|---|---|---|---|
| One year | (29.1) | (29.3) | 20 bps |
| Four Years (annualized) | (8.2) | (10.8) | 260 bps |

The Fund's actual return from non-North American equities was negative 29.1%. Over four years the Fund's non-North American equity portfolio returned a negative 8.2%, 260 basis points better than the benchmark MSCI EAFE due to superior stock selection and country allocation in Asia-Pacific region investments.

### NON-NORTH AMERICAN EQUITIES BY COUNTRY

Percent of Fair Value

At March 31, 2003, investments in non-North American equities totaled 15.7% or $1.7 billion of the Heritage Fund investment portfolio compared to 15.8% or $2.0 billion a year earlier.

### TOP TEN NON-NORTH AMERICAN EQUITY HOLDINGS

March 31, 2003

| Company | % |
|---|---|
| Vodafone Group | 2.5% |
| Glaxosmithkline | 2.0% |
| Total Fina Elf | 1.9% |
| UBS AG | 1.5% |
| Novartis AG | 1.5% |
| ENI | 1.5% |
| BP PLC | 1.5% |
| Royal Dutch Petroleum | 1.4% |
| Nestle | 1.4% |
| Nokia (AB) OY | 1.2% |

## REAL ESTATE INVESTMENTS

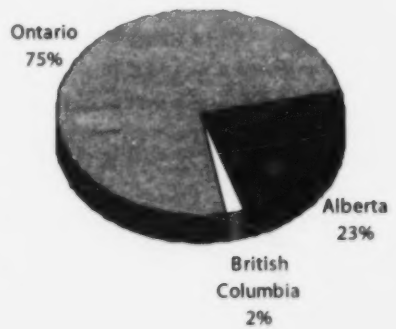
The real estate market in Canada continued in a positive trend this quarter.

| Real estate | Actual Return % | CPI plus 5%* % | Over (Under) |
|---|---|---|---|
| One year | 9.8 | 9.6 | 20 bps |
| Four Years (annualized) | 8.1 | 10.3 | (220) bps |

*Effective April 1 2002, the benchmark changed from the Russell Canadian Property Index (RCPI) to CPI plus 5%. Therefore, the benchmark for four years is a combination of RCPI and CPI plus 5%.

The Fund's real estate investments are held in the internally managed Private Real Estate Pool. Nearly half of the real estate portfolio is invested in retail, half in office and a small portion in industrial and residential. The Fund's real estate portfolio earned 9.8% this year and 8.1% over 4 years. Over the long term, the portfolio underperformed the benchmark by 220 bps due to the underperformance of Alberta retail properties and below average performance from Ontario retail and Alberta office properties.

### REAL ESTATE BY GEOGRAPHIC DISTRIBUTION




At March 31, 2003, investments in real estate totaled 7.9% or $870 million of the Heritage Fund investment portfolio compared to 4.7% or $594 million a year earlier.

# Administrative Expenses

Administrative expenses include investment management, cash management, custodial and other expenses. External management and custodial fees are deducted directly from the income of externally managed investment pools. Internal administrative expenses are deducted from the internally managed pooled funds and also directly from the Fund.

In the 2002-03 year, the administrative expenses charged directly to the Fund were $1.8 million compared to $1.5 million in 2001-02. The Fund's total administrative expense for the year ending 2002-03, including amounts deducted from the investment income of the pooled funds, amounted to $15.9 million or 0.144% of the Funds net assets at fair value compared to $11.5 million or 0.092% of net assets the previous year. According to the 2001 CEM (Cost Effectiveness Measurement) report, the average fund had investment management and administration expenses of 0.31% of total market value or the equivalent of approximately $34.3 million.

**ADMINISTRATIVE EXPENSE BREAKDOWN**

Year ended March 31, 2003

| | 2003 | 2002 |
|---|---|---|
| | *(thousands)* | |
| Direct fund expenses | $ 1,778 | $ 1,455 |
| Externally managed investment pools | 11,436 | 8,291 |
| Internally managed investment pools | 2,733 | 1,722 |
| Total | $15,947 | $11,468 |
| Expenses as a percent of net assets at fair value | 0.144% | 0.092% |

The increase in administrative expense is primarily related to an increase in US and non-North American equity investments which are externally managed and more expensive to administer.

## BUSINESS PLAN PERFORMANCE MEASURES

**HERITAGE FUND (COMBINED) (1)**

| | 2003 | 2002 | 2001 | 2000 | Four Years(2) |
|---|---|---|---|---|---|
| Actual return (%) | (11.0) | 4.2 | (0.1) | 9.0 | 0.3 |

**ENDOWMENT PORTFOLIO**

| | 2003 | 2002 | 2001 | 2000 | Four Years(2) |
|---|---|---|---|---|---|
| Actual return (%) | (11.3) | 3.3 | (6.1) | 18.0 | 0.4 |
| Benchmark return (%) | (11.7) | 3.4 | (6.2) | 15.9 | (0.2) |
| Over (under) benchmark | 0.4 | (0.1) | 0.1 | 2.1 | 0.6 |

| | Actual Weight | Actual return (%) 2003 | 2002 | 2001 | 2000 | Four Years(2) |
|---|---|---|---|---|---|---|
| ST Fixed income | 2.3 | 3.0 | 3.8 | 5.7 | 5.3 | 4.5 |
| LT Fixed income | 33.5 | 9.5 | 5.9 | 9.5 | 1.7 | 6.6 |
| Canadian public equities | 21.4 | (16.6) | 4.2 | (16.0) | 37.8 | 0.1 |
| US public equities | 15.8 | (30.6) | 1.4 | (14.4) | 13.1 | (9.2) |
| EAFE public equities | 15.7 | (29.1) | (5.8) | (22.6) | 37.3 | (8.2) |
| Private equities (3) | 0.8 | (3.3) | n/a | n/a | n/a | n/a |
| Real Estate | 7.9 | 9.8 | 7.3 | 9.7 | 5.8 | 8.1 |
| Absolute Return Strategies (3) | 2.6 | 1.6 | n/a | n/a | n/a | n/a |
| Total | 100.0 | (11.3) | 3.3 | (6.1) | 18.0 | 0.4 |

| | Long-term Policy Weight | Benchmark return (%) 2003 | 2002 | 2001 | 2000 | Four Years(2) |
|---|---|---|---|---|---|---|
| ST Fixed Income | 2.0 | 2.7 | 3.7 | 5.7 | 4.7 | 4.2 |
| LT Fixed Income | 33.0 | 9.2 | 5.1 | 8.7 | 1.3 | 6.0 |
| Canadian Equities | 20.0 | (17.6) | 4.9 | (18.6) | 45.5 | 0.6 |
| US Equities | 15.0 | (30.7) | 1.6 | (15.1) | 13.2 | (9.3) |
| EAFE Equities | 15.0 | (29.3) | (7.3) | (19.6) | 20.1 | (10.8) |
| Private Equities (3) | 2.0 | 5.7 | n/a | n/a | n/a | n/a |
| Real Estate | 10.0 | 9.6 | 9.9 | 11.9 | 9.9 | 10.3 |
| Absolute Return Strategies (3) | 3.0 | 4.7 | n/a | n/a | n/a | n/a |
| Total | 100.0 | (11.7) | 3.4 | (6.2) | 15.9 | (0.2) |

**TRANSITION PORTFOLIO (1)**

| | Six Months 2003 | 2002 | 2001 | 2000 | Four Years(2) |
|---|---|---|---|---|---|
| Actual return (%) | 0.5 | 5.3 | 8.2 | 3.0 | n/a |

(1) The Transition Portfolio was wound up in the first half of the year. The combined Heritage Fund return includes the past performance of the Transition Portfolio.

(2) Annualized

(3) Six months returns

## HISTORICAL SUMMARY OF OPERATIONS

May 19, 1976 to March 31, 2003 *(millions)*

| | Net Income (Loss) | Transfers From GRF | Transfers To GRF | Capital Expenditures | Fund Equity (a) |
|---|---|---|---|---|---|
| 1976/77 | $88 | $2,120 | - | ($36) | $2,172 |
| 1977/78 | 194 | 931 | - | (87) | 3,210 |
| 1978/79 | 294 | 1,059 | - | (132) | 4,431 |
| 1979/80 | 343 | 1,332 | - | (478) | 5,628 |
| 1980/81 | 724 | 1,445 | - | (227) | 7,570 |
| 1981/82 | 1,007 | 1,433 | - | (349) | 9,661 |
| 1982/83 | 1,482 | 1,370 | (866) | (296) | 11,351 |
| 1983/84 | 1,467 | 720 | (1,469) | (330) | 11,739 |
| 1984/85 | 1,575 | 736 | (1,575) | (228) | 12,247 |
| 1985/86 | 1,667 | 685 | (1,667) | (240) | 12,692 |
| 1986/87 | 1,445 | 216 | (1,445) | (227) | 12,681 |
| 1987/88 | 1,353 | - | (1,353) | (129) | 12,552 |
| 1988/89 | 1,252 | - | (1,252) | (155) | 12,397 |
| 1989/90 | 1,244 | - | (1,244) | (134) | 12,263 |
| 1990/91 | 1,337 | - | (1,337) | (150) | 12,113 |
| 1991/92 | 1,382 | - | (1,382) | (84) | 12,029 |
| 1992/93 | 785 | - | (785) | (84) | 11,945 |
| 1993/94 | 1,103 | - | (1,103) | (71) | 11,874 |
| 1994/95 | 914 | - | (914) | (49) | 11,825 |
| 1995/96 | 1,046 | - | (1,046) | - | 11,825 |
| 1996/97 | 932 | - | (756) | - | 12,001 |
| 1997/98 | 947 | - | (922) | - | 12,026 |
| 1998/99 | 932 | - | (932) | - | 12,026 |
| 1999/2000 | 1,169 | - | (939) | - | 12,256 |
| 2000/01 | 706 | - | (706) | - | 12,256 |
| 2001/02 | 206 | - | (206) | - | 12,256 |
| 2002/03 | (894) | - | - | - | 11,362 |
| TOTAL | $24,700 | $12,047 | ($21,899) | ($3,486) | $11,362 |

(a) at cost

**FINANCIAL STATEMENTS**

**MARCH 31, 2003**

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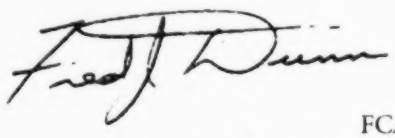
# Auditor's Report

**TO THE MINISTER OF REVENUE**

I have audited the balance sheet of the Alberta Heritage Savings Trust Fund as at March 31, 2003 and the statements of operations and changes in financial position for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2003 and the results of its operations and the changes in its financial position for the year then ended in accordance with Canadian generally accepted accounting principles.



FCA
Auditor General

Edmonton, Alberta
May 22, 2003

# FINANCIAL STATEMENTS

## BALANCE SHEET

***March 31, 2003 (thousands)***

| | 2003 | 2002 |
|---|---|---|
| **Assets** | | |
| Portfolio investments (Note 3) | $ 11,346,295 | $ 12,501,716 |
| Accrued interest income | 16,145 | 20,617 |
| Receivable from sale of investments | – | 16,163 |
| Administration expense receivable | 2 | 7 |
| | $ 11,362,442 | $ 12,538,503 |
| **Liabilities and Fund Equity** | | |
| Liabilities | | |
| Liabilities for investment purchases | $ – | $ 269,287 |
| Due to the General Revenue Fund | – | 12,897 |
| | – | 282,184 |
| Fund equity (Note 6) | 11,362,442 | 12,256,319 |
| | $ 11,362,442 | $ 12,538,503 |

## STATEMENT OF OPERATIONS

***For the Year Ended March 31, 2003 (thousands)***

| | 2003 | | 2002 |
|---|---|---|---|
| | Budget | Actual | Actual |
| Net income (loss) (Note 7) | $ 590,500 | $ (893,877) | $ 205,772 |
| Transfers to the General Revenue Fund (Note 6) | 590,500 | – | 205,772 |
| Net change in fund equity (Note 6) | $ – | (893,877) | – |
| Fund equity at beginning of year | | 12,256,319 | 12,256,319 |
| Fund equity at end of year | | $ 11,362,442 | $ 12,256,319 |

The accompanying notes and schedules are part of these financial statements.

FINANCIAL STATEMENTS

## STATEMENT OF CHANGES IN FINANCIAL POSITION

***For the Year Ended March 31, 2003 (thousands)***

| | 2003 | 2002 |
|---|---|---|
| **Operating transactions** | | |
| Net income (loss) | $ (893,877) | $ 205,772 |
| Non-cash items included in net income | 58,636 | (56,841) |
| | (835,241) | 148,931 |
| Decrease in accounts receivable | 20,640 | 82,423 |
| Increase (decrease) in accounts payable | (269,287) | 124,272 |
| Cash provided by (applied to) operating transactions | (1,083,888) | 355,626 |
| **Investing transactions** | | |
| Proceeds from disposals, repayments and redemptions of investments | 5,524,009 | 12,881,740 |
| Purchase of investments | (4,228,530) | (13,338,370) |
| Cash provided by (applied to) investing transactions | 1,295,479 | (456,630) |
| **Transfers** | | |
| Transfers to the General Revenue Fund | – | (205,772) |
| Increase (decrease) in amounts due to the General Revenue Fund | (12,897) | 94,721 |
| Cash applied to transfers | (12,897) | (111,051) |
| **Increase (decrease) in cash** | 198,694 | (212,055) |
| **Cash at beginning of year** | 51,820 | 263,875 |
| **Cash at end of year** | $ 250,514 | $ 51,820 |
| **Consisting of Deposits in the Consolidated Cash Investment Trust Fund (Note 3)** | $ 250,514 | $ 51,820 |

The accompanying notes and schedules are part of these financial statements.

# FINANCIAL STATEMENTS

## NOTES TO THE FINANCIAL STATEMENTS
***March 31, 2003***

### NOTE 1 AUTHORITY AND MISSION

The Alberta Heritage Savings Trust Fund operates under the authority of the *Alberta Heritage Savings Trust Fund Act* (the Act), Chapter A-23, Revised Statutes of Alberta 2000, as amended.

The preamble to the Act describes the mission of the Fund as follows:

*"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans."*

### NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

These financial statements are prepared in accordance with generally accepted accounting principles.

The accounting policies of significance to the Fund are as follows:

**(a) Portfolio investments**

Fixed-income securities, mortgages, equities, real estate investments and absolute return strategy investments held directly by the Fund or by pooled investment funds are recorded at cost. Cost includes the amount of applicable amortization of discount or premium using the straight-line method over the life of the investments.

Investments in loans are recorded at cost less any allowance for credit loss. Where there is no longer reasonable assurance of timely collection of the full amount of principal and interest of a loan, a specific provision for credit loss is made and the carrying amount of the loan is reduced to its estimated realizable amount.

Investments are recorded as of the trade date. The cost of disposals is determined on the average cost basis.

Where there has been a loss in value of an investment in fixed-income securities, mortgages, equities, real estate and absolute return strategies that is other than a temporary decline, the investment is written down to recognize the loss. The written down value is deemed to be the new cost.

**(b) Investment Income**

Investment income is recorded on the accrual basis where there is reasonable assurance as to its measurement and collectability. When a loan becomes impaired, recognition of interest income in accordance with the terms of the original loan agreement ceases. Any subsequent payments received on an impaired loan are applied to reduce the loan's book value.

Gains and losses arising as a result of disposals of investments are included in the determination of investment income. Income and expense from derivative contracts are included in investment income.

**(c) Foreign Currency**

Foreign currency transactions are translated into Canadian dollars using average rates of exchange, except for hedged foreign currency transactions which are translated at rates of exchange established by the terms of the forward exchange contracts. Exchange differences on unhedged transactions are included in the determination of investment income.

**(d) Investment Valuation**

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no

## FINANCIAL STATEMENTS

**Note 2 (continued)**

compulsion to act. Fair values of investments held either directly by the Fund or by pooled investment funds are determined as follows:

(i) Public fixed-income securities and equities are valued at the period-end closing sale price, or the average of the latest bid and ask prices quoted by an independent securities valuation company.

(ii) Mortgages, provincial corporation debentures and private fixed-income securities are valued based on the net present value of future cash flows. These cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market.

(iii) The fair value of private equities is estimated by management.

(iv) Real estate investments are reported at their most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers.

(v) The fair value of Absolute Strategy Pool investments are estimated by external managers.

(vi) The fair value of loans is estimated by management based on the present value of discounted cash flows.

(vii) The fair value of deposits, receivables, accrued interest and payables are estimated to approximate their book values.

(viii) The fair value of investments and any other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rate.

**(e) Valuation of Derivative Contracts**

Derivative contracts include equity and bond index swaps, interest rate swaps, forward foreign exchange contracts, equity index futures contracts and cross-currency interest rate swaps. As disclosed in Note 4, the value of derivative contracts is included in the fair value of pooled investment funds. The estimated amount receivable or payable from derivative contracts at the reporting date is determined by the following methods:

(i) Equity and bond index swaps are valued based on changes in the appropriate market based index net of accrued floating rate interest.

(ii) Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields. The fair value of cross-currency interest rate swaps was not available in prior years. Consequently, no amount is provided for comparative purposes.

(iii) Forward foreign exchange contracts and equity index futures contracts are based on quoted market prices.

# FINANCIAL STATEMENTS

## NOTE 3 PORTFOLIO INVESTMENTS

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Cost | Fair Value | % | Cost | Fair Value | % |
| | *(thousands)* | | | *(thousands)* | | |
| **Fixed income securities (Schedule A)** | | | | | | |
| Deposit in the Consolidated Cash Investment Trust Fund (a) | $ 250,514 | $ 250,514 | 2.3 | $ 51,820 | $ 51,820 | 0.4 |
| Canadian Dollar Public Bond Pool (b ) | 3,012,610 | 2,996,258 | 27.1 | 3,372,717 | 3,291,655 | 26.0 |
| Bonds, notes & short-term paper, directly held (c) | 24,515 | 25,470 | 0.2 | 1,440,792 | 1,445,674 | 11.4 |
| Private Mortgage Pool (d) | 432,916 | 429,077 | 3.9 | 404,966 | 389,516 | 3.1 |
| Provincial corporation debentures, directly held (e) | 100,037 | 158,018 | 1.4 | 104,622 | 165,178 | 1.3 |
| Loans, directly held (f) | 97,359 | 97,359 | 0.9 | 97,359 | 97,359 | 0.8 |
| | **3,917,951** | **3,956,696** | **35.8** | **5,472,276** | **5,441,202** | **43.0** |
| **Canadian equities (Schedule B)** | | | | | | |
| Public equities: | | | | | | |
| Domestic Passive Equity Pooled Fund (g) | 907,115 | 1,050,459 | 9.5 | 886,167 | 1,097,763 | 8.7 |
| External Managers Canadian Large Cap Equity Pool (h) | 672,938 | 638,043 | 5.8 | 380,554 | 406,097 | 3.2 |
| Canadian Pooled Equity Fund (i) | 647,209 | 596,641 | 5.4 | 931,972 | 945,662 | 7.5 |
| External Managers Canadian Small Cap Equity Pool (j) | 72,655 | 80,751 | 0.7 | 67,471 | 88,027 | 0.7 |
| Public equities, directly held | – | – | – | 1,526 | 2,716 | – |
| | 2,299,917 | 2,365,894 | 21.4 | 2,267,690 | 2,540,265 | 20.1 |
| Private Equity Pools (k) | 93,047 | 83,160 | 0.7 | 86,069 | 83,047 | 0.6 |
| | **2,392,964** | **2,449,054** | **22.1** | **2,353,759** | **2,623,312** | **20.7** |
| **United States equities (Schedule C)** | | | | | | |
| Public equities: | | | | | | |
| External Managers US Large Cap Equity Pool (l) | 894,835 | 753,677 | 6.8 | 891,430 | 879,969 | 6.9 |
| External Manager US Passive Equity Pool (m) | 505,192 | 462,155 | 4.2 | 1,104,863 | 994,944 | 7.9 |
| S&P 500 Index Fund (n) | 443,426 | 429,631 | 3.9 | – | – | – |
| External Manager US Small/Mid Cap Equity Pool (o) | 111,304 | 106,645 | 0.9 | 102,321 | 122,653 | 1.0 |
| United States Pooled Equity Fund | 255 | 105 | – | 803 | 640 | – |
| | 1,955,012 | 1,752,213 | 15.8 | 2,099,417 | 1,998,206 | 15.8 |
| Private Equity Pool (k) | 7,155 | 6,839 | 0.1 | – | – | – |
| | **1,962,167** | **1,759,052** | **15.9** | **2,099,417** | **1,998,206** | **15.8** |
| **Non-North American equities (Schedule D)** | | | | | | |
| External Managers EAFE Core Equity Pool (p) | 1,054,819 | 876,238 | 7.9 | 1,013,353 | 994,087 | 7.8 |
| External Managers EAFE Plus Equity Pool (p) | 518,725 | 437,568 | 3.9 | 488,475 | 499,732 | 4.0 |
| External Manager EAFE Passive Equity Pool (q) | 411,772 | 427,300 | 3.9 | 505,888 | 507,434 | 4.0 |
| EAFE Structured Equity Pool | – | – | – | 803 | 818 | – |
| | **1,985,316** | **1,741,106** | **15.7** | **2,008,519** | **2,002,071** | **15.8** |
| **Real estate** | | | | | | |
| Private Real Estate Pool (r) | **804,855** | **869,948** | **7.9** | **567,745** | **594,463** | **4.7** |
| **Absolute Return Strategies** | | | | | | |
| Absolute Return Strategy Pool (s) | **283,042** | **282,967** | **2.6** | – | – | – |
| Total equities, real estate and absolute return strategies | 7,428,344 | 7,102,127 | 64.2 | 7,029,440 | 7,218,052 | 57.0 |
| **Total investments (t)** | **$ 11,346,295** | **$ 11,058,823** | **100.0** | **$ 12,501,716** | **$ 12, 659,254** | **100.0** |

## FINANCIAL STATEMENTS

The majority of the Fund's investments are held in pooled investment funds established and administered by Alberta Revenue. Pooled investment funds have a market based unit value that is used to allocate income to participants and to value purchases and sales of pool units. As at March 31, 2003, the Fund's percentage ownership, at market, in pooled investment funds is as follows:

| | % Ownership | |
|---|---|---|
| | 2003 | 2002 |
| **Internally Managed Investment Pools** | | |
| Canadian Dollar Public Bond Pool | 38.1 | 36.9 |
| Canadian Pooled Equity Fund | 55.0 | 47.0 |
| Domestic Passive Equity Pooled Fund | 47.7 | 41.3 |
| EAFE Structured Equity Pool | – | 0.2 |
| Foreign Private Equity Pool (02) | 43.8 | – |
| Private Equity Pool | 13.6 | 13.6 |
| Private Equity Pool (98) | 100.0 | 100.0 |
| Private Equity Pool (02) | 62.1 | – |
| Private Mortgage Pool | 42.8 | 43.2 |
| Private Real Estate Pool | 42.8 | 36.3 |
| S&P 500 Index Fund | 87.2 | – |
| United States Pooled Equity Fund | 18.0 | 18.0 |
| **Externally Managed Investment Pools** | | |
| Absolute Return Strategy Pool | 88.2 | – |
| Canadian Large Cap Equity Pool | 25.5 | 18.8 |
| Canadian Small Cap Equity Pool | 18.6 | 18.7 |
| EAFE Core Equity Pool | 35.6 | 36.2 |
| EAFE Passive Equity Pool | 74.0 | 56.6 |
| EAFE Plus Equity Pool | 37.1 | 35.4 |
| US Large Cap Equity Pool | 41.6 | 37.0 |
| US Passive Equity Pool | 73.3 | 68.9 |
| US Small/Mid Cap Equity Pool | 26.9 | 30.2 |

(a) The Consolidated Cash Investment Trust Fund is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at March 31, 2003, securities held by the Fund have an average effective market yield of 3.23% per annum (2002: 2.57% per annum).

(b) The Canadian Dollar Public Bond Pool is managed with the objective of providing above average returns compared to the total return of the Scotia Capital Universe Bond Index over a four-year period while maintaining adequate security and liquidity of participants' capital. The excess return is achieved through management of portfolio duration and sector rotation. The portfolio is comprised of high quality Canadian fixed-income instruments and debt related derivatives. As at March 31, 2003, securities held by the Pool have an average effective market yield of 5.41% per annum (2002: 5.80% per annum) and the following term structure based on principal amount: under 1 year: 2% (2002: 7%); 1 to 5 years: 37% (2002: 34%); 5 to 10 years: 31% (2002: 31%); 10 to 20 years: 11% (2002: 10%); over 20 years: 19% (2002: 18%).

(c) As at March 31, 2003, fixed-income securities held directly by the Fund have an average effective market yield of 4.36% per annum (2002: 4.02% per annum). As at March 31, 2003, fixed-income securities have the following term structure based on principal amount: under 1 year: Nil % (2002: 91%); 1 to 5 years: 100% (2002: 9%).

(d) The Private Mortgage Pool is managed with the objective of providing investment returns higher than attainable from the Scotia Capital Universe Bond Index over a four-year period or longer. The portfolio is comprised primarily of high quality commercial mortgage loans (94.6%) and provincial bond residuals (5.4%). To limit investment risk, mortgage loans are restricted to first mortgage loans, diversified by property usage and geographic location, and include a small portion of NHA insured loans. As at March 31, 2003, securities held by the Pool have an average effective market yield of 6.43% per annum (2002: 7.01% per annum) and the following term structure based on principal amount: under 1 year: 5% (2002: 10%); 1 to 5 years: 31% (2002: 21%); 5 to 10 years: 20% (2002: 23%); 10 to 20 years: 24% (2002: 26%); and over 20 years: 20% (2002: 20%).

## FINANCIAL STATEMENTS

(e) As at March 31, 2003, Provincial corporation debentures have an average effective market yield of 7.83% per annum (2002: 8.35% per annum) and the following term structure based on principal amounts: 5 to 10 years: 100%.

(f) Investment in loans are recorded at cost. The fair value of loans is estimated by management based on the present value of discounted cash flows. As at March 31, 2003, investment in loans, at cost, include the Ridley Grain loan amounting to $91,245,000 (2002: $91,245,000) and the Vencap loan amounting to $6,114,000 (2002: $6,114,000).

- Under the terms of the loan to Ridley Grain, 11% Participating First Mortgage Bonds due July 31, 2015, interest is compounded semi-annually and payable annually to the extent of available cash flow and any shortfall is to be deferred and capitalized. The principal of $91,245,000 and deferred interest is repayable on or before July 31, 2015. Deferred interest at March 31, 2003 amounted to $76,189,320 (2002: $60,049,081). Grain throughput volumes are the main determinant of profitability of the grain terminal and the value of the loan to the Fund. Due to the uncertainty of forecasting the grain throughput volumes, income from the participating bonds is recognized when it is measurable and collectable.

- The principal amount of the Vencap loan, amounting to $52,588,000, is due July 2046 and bears no interest. Amortization ceased being recorded on the loan from December 31, 2000 onward.

(g) The Domestic Passive Equity Pooled Fund is managed on a passive approach with the objective of providing investment returns comparable to the S&P/TSX Index. A portion of the portfolio is comprised of both publicly traded Canadian equities and structured investments replicating the S&P/TSX 100 Index and the S&P/TSX 60 Index. The other portion of the portfolio fully replicates the S&P/TSX. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool. FRNP is managed with the objective of generating floating rate income needed for the swap obligations in respect of structured investments in foreign equities, domestic equities and domestic bonds. Through the use of interest rate swaps, FRNP provides investment opportunities in high quality floating-rate instruments with remaining term-to-maturity of ten years or less.

(h) The Canadian Large Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities. Each portfolio is actively managed by an external manager with expertise in the Canadian large cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX index over a four-year period. Return volatility is reduced through multiple manager investment style and market capitalization focus.

(i) The Canadian Pooled Equity Fund is managed with the objective of providing competitive returns comparable to the total return of the S&P/TSX Index while maintaining maximum preservation of participants' capital. The portfolio is comprised of publicly traded equities in Canadian corporations. Risk is reduced by prudent security selection and sector rotation.

(j) The Canadian Small Cap Equity Pool consists of multiple portfolios of publicly traded Canadian equities with market capitalization of .15% of the S&P/TSX Index total market capitalization at time of purchase. Each portfolio is actively managed by an external

## FINANCIAL STATEMENTS

manager with expertise in the Canadian small cap equity market. The performance objective is to provide returns higher than the total return of the S&P/TSX index over a four-year period and returns higher than the Nesbitt Burns Small Cap Index over shorter time periods. Return volatility is reduced through multiple manager investment style and small capitalization focus.

(k) Private Equity Pools are managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 8.0%. The Private Equity Portfolio consists of the Private Equity Pool, PEP98, PEP02 and the Foreign Private Equity Pool 2002. Private equity investments are held in institutionally sponsored private equity pools. Risk is reduced by avoiding direct investments in private companies and by limiting holdings in any single pool.

(l) The US Large Cap Equity Pool consists of multiple portfolios of publicly traded United States equities. Each portfolio is actively managed by an external manager with expertise in the US large cap equity market. The performance objective is to provide returns higher than the total return of the Standard & Poor's (S&P) 500 index over a four-year period. Return volatility is reduced through multiple manager investment style and large capitalization focus.

(m) Publicly traded US equities held in the externally managed US Passive Equity Pool replicate the Standard & Poor's (S&P) 500 index. The performance objective is to provide returns comparable to the total return of the S&P 500 index over a four-year period.

(n) Publicly traded US equities held in the S & P 500 Index Fund replicate the Standard & Poor's (S&P) 500 index. The performance objective is to provide returns comparable to the total return of the S&P 500 index over a four-year period. The Pool's investment in units of the Floating Rate Note Pool (FRNP) are used as the underlying securities to support the index swaps of the pool (see Note 3g).

(o) The US Small/Mid Cap Equity Pool consists of one portfolio of publicly traded United States equities. The portfolio is actively managed by an external manager with expertise in the small cap and mid cap US equity market. The performance objective is to provide returns higher than the total return of the Russell 2500 index over a four-year period.

(p) The Europe, Australasia and Far East (EAFE) Core and Plus Equity Pools consist of multiple portfolios of publicly traded non-North American equities. EAFE Core portfolios are actively managed by external managers with European and Pacific Basin mandates. EAFE core managers have constraints on foreign currency management and deviations from the MSCI EAFE index asset mix by country. The EAFE Plus portfolios are actively managed by external managers with less constraints on country allocation, stock selection, currency management and investments in emerging markets. The performance objective is to provide returns higher than the total return of the Morgan Stanley Capital International (MSCI) EAFE index over a four-year period.

(q) The externally managed EAFE Passive Equity Pool consists of one portfolio of non-North American publicly traded equities that replicate the MSCI EAFE index. The performance objective is to provide returns comparable to the total return of the MSCI EAFE index over a four-year period.

(r) The Private Real Estate Pool is managed with the objective of providing investment returns higher than the Consumer Price Index plus 5%. Real estate is held through intermediary

companies which have issued to the Pool, common shares and participating debentures secured by a charge on real estate. Risk is reduced by investing in properties that provide diversification by geographic location, by property type and by tenancy. As real estate returns are positively correlated to inflation and negatively correlated to returns from fixed income securities and equities, the Pool provides diversification from the securities market with opportunities for high return.

(s) The Absolute Return Strategy Pool is managed with the objective of providing investment returns higher than the Consumer Price Index (CPI) plus 6%. The Pool uses external managers who employ various investment strategies. These strategies are expected to produce absolute positive investment returns with lower volatility.

(t) Where there has been a loss in value of an investment that is other than a temporary decline, the cost of the investment is written down to recognize the loss (see Note 2 (a)). Where the fair value remains less than cost, after recording a writedown, it is management's best judgement that the decline in value is caused by short term market trends and are temporary in nature.

**NOTE 4 DERIVATIVE CONTRACTS**

Derivative contracts are financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates. The Fund uses derivative contracts held indirectly through pooled investment funds to enhance return, manage exposure to interest rate risk and foreign currency risk and for asset mix management purposes. The notional value of a derivative contract represents the amount to which a rate or price is applied in order to calculate the exchange of cash flows.

(i) A swap is a contractual agreement between two counter-parties to exchange a series of cash flows based on a notional amount. An equity or bond index swap involves the exchange of a floating interest rate cash flow for one based on the performance of a market index. For interest rate swaps, parties generally exchange fixed and floating rate interest cash flows based on a notional amount. Cross-currency interest rate swaps are contractual obligations in which the principal amounts of Canadian fixed-income securities denominated in foreign currency are exchanged for Canadian currency amounts both initially and at maturity. Over the term of the cross-currency swap, counter-parties exchange fixed to fixed and fixed to floating interest rate cash flows in the swapped currencies. There are underlying securities supporting all swaps. Leveraging is not allowed.

(ii) Forward foreign exchange contracts are contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) An equity index futures contract is an agreement to receive or pay cash based on changes in the level of the specified stock index.

## FINANCIAL STATEMENTS

The following is a summary of the fund's proportionate share of the notional amount and fair value of derivative contracts held by pooled funds at March 31, 2003.

| | Maturity | | | 2003 | | 2002 | |
|---|---|---|---|---|---|---|---|
| | Under 1 Year | 1 to 3 Years | Over 3 Years | Notional Amount | Fair Value (a) | Notional Amount | Fair Value (a) |
| | | | | *(thousands)* | | | |
| Equity index swap contracts | 91% | 9% | – | $ 575,028 | $ (13,298) | $ 510,859 | $ 7,733 |
| Bond index swap contracts | 100% | – | – | 52,107 | (173) | 55,553 | (491) |
| Forward foreign exchange contracts | 100% | – | – | 616,346 | 21,069 | 260,664 | 182 |
| Interest rate swap contracts | 33% | 64% | 3% | 404,230 | (13,765) | 230,634 | (8,479) |
| Equity index futures contracts | 100% | – | – | 13,754 | 421 | – | – |
| Cross-currency interest rate swaps | 21% | 16% | 63% | 275,384 | (52,399) | 380,982 | (b) |
| | | | | $ 1,936,849 | $ (58,145) | $ 1,438,692 | $ (1,055) |

(a) The method of determining the fair value of derivative contracts is described in note 2 (c).
(b) Comparative figures at March 31, 2002 are not provided as the fair value of cross-currency interest rate swaps was not available in prior years.

### NOTE 5 INVESTMENT RISK MANAGEMENT

Income and financial returns of the Fund are exposed to credit risk and price risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Price risk is comprised of currency risk, interest rate risk and market risk. Currency risk relates to the possibility that the investments will change in value due to future fluctuations in foreign exchange rates. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. Market risk relates to the possibility that the investments will change in value due to future fluctuations in market prices.

The Standing Committee on the Alberta Heritage Savings Trust Fund reviews and approves the business plan of the Fund. In order to earn an optimal financial return at an acceptable level of risk, the 2002-2003 business plan proposes the following asset mix policy for the Endowment Portfolio.

| | |
|---|---|
| Fixed income securities | 25% to 45% |
| Equities | 75% to 55% |

Risk is reduced through asset class diversification, diversification within each asset class, quality and duration constraints on fixed-income instruments, and restrictions on amounts exposed to countries designated as emerging markets. Controls are in place respecting the use of derivatives (see Note 4). Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in foreign currency (see Note 4).

### NOTE 6 FUND EQUITY

Section 8 (2) of the *Alberta Heritage Savings Trust Fund Act* (the Act) states that the net income of the Heritage Fund less any amount retained in the Fund to maintain its value shall be transferred to the General Revenue Fund annually in a manner determined by the Minister of Revenue.

Section 11(5) of the Act states that for fiscal years subsequent to 1999 and until the accumulated debt is eliminated in accordance with the *Fiscal Responsibility Act*, the Minister of Revenue is not required to retain any income in the Heritage Fund to maintain its value, but may retain such amounts as the Minister of Revenue considers advisable.

# FINANCIAL STATEMENTS

## NOTE 7 NET INCOME (LOSS)

| | 2003 | 2002 |
|---|---|---|
| | *(thousands)* | |
| Deposit and fixed-income securities | $ 286,427 | $ 444,884 |
| Canadian equities | (240,581) | (54,112) |
| United States equities | (591,448) | (8,065) |
| Non-North American equities | (390,325) | (213,481) |
| Real estate | 39,265 | 38,001 |
| Absolute Return Strategies | 4,563 | – |
| **Investment income (loss)** | (892,099) | 207,227 |
| Direct administrative expenses (Note 8) | (1,778) | (1,455) |
| **Net income (loss)** | $ (893,877) | $ 205,772 |

Investment income (loss) is comprised of interest, dividends, amortization of discount and premiums, swap income, security lending income and realized gains and losses, net of write-downs, on investments. The Fund's share of income earned from externally and internally managed investment pools is net of administrative expenses incurred by the pools. (see Note 8).

The investment loss for the year ended March 31, 2003 includes writedowns totalling $668,553,000 (March 31, 2002: $269,283,000).

## NOTE 8 ADMINISTRATIVE EXPENSES

Administrative expense includes investment management, cash management, safekeeping costs and other expenses charged on a cost-recovery basis directly from Alberta Revenue. The Fund's total administrative expense for the period, including amounts deducted directly from investment income of pooled funds is as follows:

| | 2003 | 2002 |
|---|---|---|
| | *(thousands)* | |
| Direct fund expenses, (Note 7) | $ 1,778 | $ 1,455 |
| Externally managed investment pools | 11,436 | 8,291 |
| Internally managed investment pools | 2,733 | 1,722 |
| Total | $ 15,947 | $ 11,468 |
| Percent of net assets at fair value | 0.144% | 0.092% |

## NOTE 9 COMPARATIVE FIGURES

Certain 2002 figures have been reclassified to conform to 2003 presentation.

## NOTE 10 APPROVAL OF FINANCIAL STATEMENTS

These financial statements were approved by the Deputy Minister of Revenue.

# FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN FIXED INCOME SECURITIES

**Schedule A**

**March 31, 2003 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2003 | | 2002 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 258,716 | $ 258,716 | $ 90,252 | $ 90,252 |
| **Fixed Income Securities (a)** | | | | |
| Corporate, public and private | 2,134,498 | 2,115,369 | 3,161,066 | 3,116,173 |
| Government of Canada, direct and guaranteed | 639,630 | 640,529 | 1,181,806 | 1,157,039 |
| Provincial, direct and guaranteed: | | | | |
| Alberta | 6,786 | 7,370 | 9,861 | 10,271 |
| Other provinces | 584,015 | 581,516 | 744,038 | 722,116 |
| Municipal | 62,260 | 63,169 | 49,249 | 48,791 |
| Provincial corporation debentures | 100,037 | 158,018 | 104,622 | 165,178 |
| Loans | 97,359 | 97,359 | 97,359 | 97,359 |
| | 3,624,585 | 3,663,330 | 5,348,001 | 5,316,927 |
| Receivable from sale of investments and accrued investment income | 41,239 | 41,239 | 78,837 | 78,837 |
| Accounts payable and accrued liabilities | (6,589) | (6,589) | (44,814) | (44,814) |
| | 34,650 | 34,650 | 34,023 | 34,023 |
| | $ 3,917,951 | $ 3,956,696 | $ 5,472,276 | $ 5,441,202 |

(a) Fixed income securities held as at March 31, 2003 have an average effective market yield of 5.68% per annum (2002: 5.41% per annum) and the following term structure based on principal amount:

| | 2003 | 2002 |
|---|---|---|
| | % | % |
| under 1 year | 2 | 31 |
| 1 to 5 years | 36 | 26 |
| 5 to 10 years | 31 | 21 |
| 10 to 20 years | 13 | 9 |
| over 20 years | 18 | 13 |
| | 100 | 100 |

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENTS IN CANADIAN EQUITIES

**Schedule B**

**March 31, 2003 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2003 | | 2002 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 23,056 | $ 23,056 | $ 34,647 | $ 34,647 |
| **Public equities (a)(b)** | | | | |
| Financial | 717,653 | 759,882 | 643,536 | 746,185 |
| Energy | 297,762 | 368,554 | 233,727 | 328,373 |
| Materials | 363,479 | 359,403 | 341,579 | 368,738 |
| Industrials | 174,582 | 172,681 | 222,834 | 243,199 |
| Consumer discretionary | 193,152 | 171,206 | 210,139 | 207,260 |
| Information technology | 151,830 | 122,174 | 218,158 | 209,338 |
| Telecommunication services | 126,947 | 120,503 | 91,633 | 92,381 |
| Consumer staples | 88,729 | 101,180 | 78,482 | 98,663 |
| Utilities | 76,729 | 83,199 | 57,570 | 69,157 |
| Health Care | 86,322 | 80,995 | 96,768 | 100,588 |
| | 2,277,185 | 2,339,777 | 2,194,426 | 2,463,882 |
| Passive index | 16,456 | 16,680 | 30,234 | 32,015 |
| | 2,293,641 | 2,356,457 | 2,224,660 | 2,495,897 |
| **Private equities** | 88,295 | 81,569 | 81,175 | 79,491 |
| Receivable from sale of investments and accrued investment income | 6,579 | 6,579 | 21,319 | 21,319 |
| Accounts payable and accrued liabilities | (18,607) | (18,607) | (8,042) | (8,042) |
| | (12,028) | (12,028) | 13,277 | 13,277 |
| | **$ 2,392,964** | **$ 2,449,054** | **$ 2,353,759** | **$ 2,623,312** |

(a) The Fund's effective net investment in Canadian public equities includes the fair value of deposits and floating rate notes, totalling $550,918,000 (2002: $510,081,000) which are used as underlying securities to support the notional amount of Canadian equity index swap contracts and equity index futures contracts.

(b) The industrial classifications are those used by the S&P/TSX Index.

## FINANCIAL STATEMENTS

# SCHEDULE OF INVESTMENTS IN UNITED STATES EQUITIES

**Schedule C**

**March 31, 2003 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2003 | | 2002 | |
| | Cost | Fair Value | Cost | Fair Value |
| **Deposits and short-term securities** | $ 23,198 | $ 23,198 | $ 13,110 | $ 13,110 |
| **Public equities (a) (b)** | | | | |
| Financial | 386,731 | 338,718 | 368,148 | 357,170 |
| Consumer discretionary | 326,894 | 291,626 | 290,523 | 274,590 |
| Health Care | 270,831 | 257,348 | 256,430 | 248,791 |
| Information Technology | 262,253 | 235,478 | 354,595 | 319,543 |
| Industrials | 218,911 | 191,605 | 226,164 | 223,369 |
| Consumer staples | 179,069 | 161,325 | 197,674 | 193,818 |
| Energy | 128,498 | 111,492 | 145,227 | 140,838 |
| Telecommunication services | 54,907 | 49,260 | 87,524 | 72,109 |
| Materials | 57,080 | 48,294 | 70,355 | 69,309 |
| Utilities | 45,953 | 43,141 | 79,384 | 75,298 |
| | 1,931,127 | 1,728,287 | 2,076,024 | 1,974,835 |
| Passive index | 132 | 174 | 313 | 291 |
| | 1,931,259 | 1,728,461 | 2,076,337 | 1,975,126 |
| **Private Equities** | 6,811 | 6,494 | - | - |
| Receivable from sale of investments and accrued investment income | 4,254 | 4,254 | 18,938 | 18,938 |
| Accounts payable and accrued liabilities | (3,355) | (3,355) | (8,968) | (8,968) |
| | 899 | 899 | 9,970 | 9,970 |
| | $ 1,962,167 | $ 1,759,052 | $ 2,099,417 | $ 1,998,206 |

(a) The Fund's effective net investment in US public equities includes the fair value of deposits and floating rate notes, totalling $37,384,000 (2002: $Nil) which are used as underlying securities to support the notional amount of US equity index swap contracts and equity index futures contracts.

(b) The industrial classifications are those used by the Standard & Poor's indices.

## FINANCIAL STATEMENTS

# SCHEDULE OF INVESTMENTS IN NON-NORTH AMERICAN EQUITIES — Schedule D

**March 31, 2003 (thousands)**

| | Fund's share | | | |
|---|---|---|---|---|
| | 2003 | | 2002 | |
| | Cost | Fair Value | Cost | Fair Value |
| Deposits and short-term securities | $ 64,941 | $ 64,941 | $ 31,001 | $ 31,001 |
| **Public equities (a)** | | | | |
| United Kingdom | 538,441 | 462,446 | 491,588 | 494,816 |
| Japan | 320,114 | 273,788 | 386,408 | 340,718 |
| France | 179,921 | 153,954 | 218,911 | 220,626 |
| Switzerland | 150,805 | 131,937 | 156,183 | 159,836 |
| Netherlands | 127,664 | 105,851 | 156,839 | 158,483 |
| Australia | 87,877 | 90,362 | 72,150 | 80,516 |
| Germany | 101,305 | 82,318 | 133,246 | 130,791 |
| Italy | 85,869 | 76,510 | 63,398 | 66,291 |
| Hong Kong | 56,369 | 50,019 | 51,803 | 55,963 |
| Spain | 52,331 | 46,591 | 55,380 | 52,077 |
| Finland | 34,540 | 29,649 | 33,728 | 37,807 |
| Sweden | 28,607 | 28,528 | 27,574 | 33,577 |
| Other | 169,376 | 156,056 | 132,306 | 141,565 |
| | 1,933,219 | 1,689,009 | 1,979,514 | 1,973,066 |
| Receivable from sale of investments and accrued investment income | 13,595 | 13,595 | 33,857 | 33,857 |
| Accounts payable and accrued liabilities | (26,439) | (26,439) | (35,853) | (35,853) |
| | (12,844) | (12,844) | (1,996) | (1,996) |
| | $ 1,985,316 | $ 1,741,106 | $ 2,008,519 | $ 2,002,071 |

(a) The Fund's effective net investment in Non-North American public equities includes the fair value of deposits and floating rate notes, totalling $Nil (2002: $$779,000), which are used as underlying securities to support the notional amount of Non-North American equity index swap contracts.

FINANCIAL STATEMENTS

## SCHEDULE OF INVESTMENT RETURNS

**Schedule E**

**Year Ended March 31, 2003**

The Fund uses the time-weighted rate of return based on market values to measure performance. The measure involves the calculation of the return realized by the Fund over a specified period and is a measure of the total return received from an investment dollar initially invested. Total return includes cash distributions (interest and dividend payments) and capital gains or losses (realized and unrealized).

The time-weighted rate of return measures the compounded rate of growth of the initial investment over the specified period. It is designed to eliminate the effect that the size and timing of cash flows have on the internal rate of return. The investment industry uses time-weighted rates of return calculated using market values when comparing the returns of funds with other funds or indices.

Investment returns for the Fund are as follows:

| | One Year Return | | | | 4 Year Compound Annualized Return |
|---|---|---|---|---|---|
| | 2003 | 2002 | 2001 | 2000 | |
| **Time-weighted rates of return** | | | | | |
| **Short-term fixed income** | **3.0** | **3.8** | **5.7** | **5.3** | **4.5** |
| *Scotia Capital 91-day T-Bill Index* | *2.7* | *3.7* | *5.7* | *4.7* | *4.2* |
| **Long-term fixed income** | **9.5** | **5.9** | **9.5** | **1.7** | **6.6** |
| *Scotia Capital Universe Bond Index* | *9.2* | *5.1* | *8.7* | *1.3* | *6.0* |
| **Canadian equities** | **(16.6)** | **4.2** | **(16.0)** | **37.8** | **0.1** |
| *S&P/TSX* | *(17.6)* | *4.9* | *(18.6)* | *45.5* | *0.6* |
| **United States equities** | **(30.6)** | **1.4** | **(14.4)** | **13.1** | **(9.2)** |
| *S&P 500 Index* | *(30.7)* | *1.6* | *(15.1)* | *13.2* | *(9.3)* |
| **Non-North American equities** | **(29.1)** | **(5.8)** | **(22.6)** | **37.3** | **(8.2)** |
| *MSCI EAFE Index* | *(29.3)* | *(7.3)* | *(19.6)* | *20.1* | *(10.8)* |
| **Private equities (1)** | **(3.3)** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 8% (1)* | *5.7* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Real estate** | **9.8** | **7.3** | **9.7** | **5.8** | **8.1** |
| *Consumer Price Index plus 5% (2)* | *9.6* | *9.9* | *11.9* | *9.9* | *10.3* |
| **Absolute Return Strategies** | **1.6** | **n/a** | **n/a** | **n/a** | **n/a** |
| *Consumer Price Index plus 6% (1)* | *4.7* | *n/a* | *n/a* | *n/a* | *n/a* |
| **Endowment portfolio** | **(11.3)** | **3.3** | **(6.1)** | **18.0** | **0.4** |
| *Policy Benchmark* | *(11.7)* | *3.4* | *(6.2)* | *15.9* | *(0.2)* |
| **Transition portfolio (3)** | **0.5** | **5.3** | **8.2** | **3.0** | **n/a** |
| **Overall Return** | **(11.0)** | **4.2** | **(0.1)** | **9.0** | **0.3** |

(1) Actual and benchmark returns are for six months.
(2) Effective April 1, 2002, the benchmark changed from the Russell Canadian Property Index (RCPI) to CPI plus 5%. Therefore, the benchmark for four years is a combination of RCPI and CPI plus 5%.
(3) The Transition Portfolio was wound up in the first half of the year. The actual return of 0.5% is for six months.

# List of Investments (unaudited)

The following unaudited schedules present the Heritage Fund's proportionate share of the ten largest public securities held in pooled funds administered by Alberta Revenue. For a detailed listing of all investments, please call (780) 427-3035.

## CANADIAN DOLLAR PUBLIC BOND POOL — SCHEDULE 1

### Schedule of Ten Largest Issues (based on fair value)

*as at March 31, 2003 (thousands)*

| Security Name | Coupon % Maturity Date | Heritage Fund Share Par Value | Cost | Fair Value |
|---|---|---|---|---|
| Toronto Dominion Centre | 6.30 Feb 28 08 | 129,601 | $ 133,741 | $ 133,411 |
| Bay-Wellinginton Tower | 6.40 Apr 08 13 | 112,543 | 114,960 | 111,072 |
| Province of Ontario | 6.50 Mar 08 29 | 57,133 | 62,394 | 61,184 |
| Province of Quebec | 6.25 DEC 01 10 | 28,672 | 30,068 | 30,384 |
| Province of Quebec | 6.25 Jun 01 32 | 29,027 | 30,145 | 29,557 |
| MBS-Bank of Nova Scotia | 4.90 Dec 01 12 | 28,824 | 28,649 | 27,820 |
| Bentall Centre | 6.34 Nov 26 04 | 26,683 | 27,582 | 27,166 |
| 145 King Street | 6.14 May 26 05 | 25,158 | 25,931 | 25,583 |
| Province of Nova Scotia | 6.25 Jun 01 11 | 23,643 | 24,734 | 25,007 |
| MBS - TD Bank | 4.25 Nov 01 07 | 25,219 | 25,671 | 24,718 |
| **Total Other Issues** | | | 2,508,735 | 2,500,356 |
| **Heritage Fund's Investment in the Canadian Dollar Public Bond Pool** | | | **$ 3,012,610** | **$ 2,996,258** |

## DOMESTIC PASSIVE EQUITY POOL FUND

**SCHEDULE 2**

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Floating Rate Note Pool | FRNP Pool Unit | 38,046 | $ 534,409 | $ 528,641 |
| Encana Corporation | Energy | 385 | 8,206 | 18,363 |
| BCE Inc | Telecommunications | 556 | 11,833 | 15,024 |
| Sun Life Financial Services | Financials | 496 | 9,847 | 13,771 |
| Manulife Financial Corporation | Financials | 373 | 7,813 | 13,121 |
| CDA Life Financial | Financials | 285 | 7,300 | 12,447 |
| Alcan Inc | Materials | 259 | 8,429 | 10,671 |
| Petro-Canada | Energy | 213 | 4,636 | 10,638 |
| Barrick Gold Corporation | Materials | 437 | 7,985 | 10,112 |
| Power Corporation of Canada | Materials | 274 | 5,119 | 10,103 |
| **Total Other Issues** | | | 301,538 | 407,568 |
| **Heritage Fund's Investment in the Domestic Passive Equity Pool** | | | **$ 907,115** | **$ 1,050,459** |

## EXTERNAL MANAGERS CANADIAN LARGE CAP POOL

**SCHEDULE 3**

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Royal Bank Canada | Financials | 799 | $ 39,722 | $ 45,647 |
| Bank of Nova Scotia | Financials | 760 | 35,839 | 39,432 |
| Sun Life Financial Services Inc | Financials | 1,058 | 34,656 | 29,359 |
| Toronto Dominion Bank | Financials | 904 | 32,844 | 29,278 |
| Encana Corporation | Energy | 576 | 25,076 | 27,486 |
| Petro-Canada | Energy | 537 | 19,885 | 26,827 |
| Bank of Montreal | Financials | 653 | 23,888 | 26,201 |
| BCE Inc | Telecommunication Services | 686 | 22,003 | 18,516 |
| Talisman Energy Inc | Energy | 281 | 15,866 | 16,435 |
| Biovail Corporation | Health Care | 274 | 15,844 | 16,065 |
| **Total Other Issues** | | | 407,315 | 362,797 |
| **Heritage Fund's Investment in the External Managers Canadian Large Cap Pool** | | | **$ 672,938** | **$ 638,043** |

## CANADIAN POOLED EQUITY FUND — SCHEDULE 4

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| | | Heritage Fund Share | | |
|---|---|---|---|---|
| Security Name | Major Industry Name | Shares | Cost | Fair Value |
| Royal Bank Canada | Financials | 593 | $ 24,704 | $ 33,889 |
| Bank of Nova Scotia | Financials | 473 | 18,360 | 24,536 |
| Encana Corporation | Energy | 494 | 20,241 | 23,577 |
| Bank of Montreal | Financials | 567 | 19,161 | 22,748 |
| BCE Inc | Telecommunications | 812 | 27,877 | 21,913 |
| Sun Life Financial Services | Financials | 785 | 25,819 | 21,784 |
| Manulife Financial Corporation | Financials | 572 | 23,220 | 20,092 |
| Toronto Dominion Bank | Financials | 618 | 21,057 | 20,012 |
| Canadian Imperial Bank of Commerce | Financials | 418 | 18,827 | 19,755 |
| Petro-Canada | Energy | 362 | 13,602 | 18,099 |
| **Total Other Issues** | | | 434,341 | 370,236 |
| **Heritage Fund's Investment in the Canadian Pooled Equity Fund** | | | **$ 647,209** | **$ 596,641** |

## EXTERNAL MANAGERS CANADIAN SMALL CAP POOL — SCHEDULE 5

### Schedule of Ten Largest Issues (based on fair value)

***March 31, 2003 (thousands)***

| | | Heritage Fund Share | | |
|---|---|---|---|---|
| Security Name | Major Industry Name | Shares | Cost | Fair Value |
| Winpak Ltd | Materials | 24 | $ 1,335 | $ 2,416 |
| Vermilion Energy | Energy | 172 | 2,169 | 2,112 |
| Gildan Activewear Inc | Consumer Discretionary | 46 | 986 | 1,666 |
| UNI Select Inc | Consumer Discretionary | 90 | 997 | 1,647 |
| Cascades Inc | Materials | 122 | 969 | 1,581 |
| Ritchie Brothers Auctioneers Inc | Information Technology | 33 | 1,334 | 1,527 |
| CFM Corporation | Consumer Discretionary | 111 | 1,074 | 1,526 |
| Shermag Inc | Consumer Staples | 134 | 1,512 | 1,469 |
| BMTC Group Inc | Consumer Discretionary | 91 | 539 | 1,319 |
| Richelieu Hardware Ltd | Industrials | 91 | 653 | 1,318 |
| **Total Other Issues** | | | 61,087 | 64,170 |
| **Heritage Fund's Investment in the External Managers Canadian Small Cap Pool** | | | **$ 72,655** | **$ 80,751** |

## EXTERNAL MANAGERS US LARGE CAP POOL

**SCHEDULE 6**

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Pfizer Inc | Health Care | 456 | $ 25,792 | $ 20,887 |
| Microsoft Corporation | Information Technology | 577 | 27,813 | 20,524 |
| Pepsico Inc | Consumer Staples | 332 | 24,169 | 19,537 |
| Citigroup | Financials | 365 | 23,731 | 18,494 |
| Johnson + Johnson | Health Care | 199 | 16,697 | 16,895 |
| Viacom Inc | Consumer Discretionary | 294 | 18,789 | 15,773 |
| Wyeth | Health Care | 237 | 14,175 | 13,148 |
| Colgate Palmolive Co | Consumer Staples | 153 | 12,859 | 12,240 |
| Qualcomm Inc | Information Technology | 231 | 13,392 | 12,229 |
| Federal National Mortgage Assn | Financials | 122 | 13,810 | 11,702 |
| **Total Other Issues** | | | 703,608 | 592,248 |
| **Heritage Fund's Investment in the External Managers US Large Cap Pool** | | | $ 894,835 | $ 753,677 |

## EXTERNAL MANAGERS US PASSIVE POOL

**SCHEDULE 7**

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| Microsoft Corporation | Information Technology | 429 | $ 14,781 | $ 15,245 |
| General Electric Co | Industrials | 402 | 19,202 | 15,071 |
| Exxon Mobil Corporation | Energy | 270 | 15,620 | 13,850 |
| Walmart Stores Inc | Consumer Discretionary | 177 | 13,108 | 13,523 |
| Pfizer Inc | Health Care | 247 | 13,535 | 11,308 |
| Johnson + Johnson | Health Care | 121 | 8,712 | 10,323 |
| Citigroup Inc | Financials | 204 | 11,947 | 10,305 |
| International Business Machines | Information Technology | 68 | 9,236 | 7,806 |
| American International Group Inc | Financials | 107 | 9,459 | 7,750 |
| Merck and Company Inc | Health Care | 90 | 8,724 | 7,246 |
| **Total Other Issues** | | | 380,868 | 349,728 |
| **Heritage Fund's Investment in the External Managers US Passive Pool** | | | $ 505,192 | $ 462,155 |

## S&P 500 INDEX FUND

**SCHEDULE 8**

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share Shares | Cost | Fair Value |
|---|---|---|---|---|
| Floating Rate Note Pool | FRNP Pool Units | 1,574 | $ 26,944 | $ 21,876 |
| Microsoft Corporation | Information Technology | 365 | 11,522 | 12,971 |
| General Electric Co | Industrials | 339 | 14,863 | 12,705 |
| Exxon Mobil Corporation | Energy | 229 | 12,343 | 11,768 |
| Walmart Stores Inc | Consumer Discretionary | 150 | 10,363 | 11,497 |
| Pfizer Inc | Health Care | 210 | 10,696 | 9,610 |
| Citigroup Inc | Financials | 175 | 9,557 | 8,867 |
| Johnson + Johnson | Health Care | 101 | 6,753 | 8,604 |
| International Business Machines | Information Technology | 58 | 7,300 | 6,635 |
| American International Group Inc | Financials | 89 | 7,159 | 6,459 |
| **Total Other Issues** | | | 325,926 | 318,639 |
| **Heritage Fund's Investment in the S&P 500 Index Fund** | | | **$ 443,426** | **$ 429,631** |

## EXTERNAL MANAGERS US SMALL-MID CAP EQUITY POOL

**SCHEDULE 9**

### Schedule of Top Ten Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Major Industry Name | Heritage Fund Share Shares | Cost | Fair Value |
|---|---|---|---|---|
| IDEXX Labs Inc | Health Care | 35 | $ 1,523 | $ 1,818 |
| Mid Atlantic Medical Services Inc | Health Care | 30 | 1,403 | 1,775 |
| UGI Corp New | Utilities | 21 | 976 | 1,424 |
| Storage Technology Corp | Information Technology | 47 | 1,142 | 1,393 |
| Hibernia Corp | Financials | 48 | 1,421 | 1,207 |
| Coverntry Health Care Inc | Health Care | 25 | 1,123 | 1,197 |
| Renaissance Holdings Ltd | Financials | 20 | 1,129 | 1,178 |
| Thornburg Mtg Inc | Financials | 38 | 1,079 | 1,158 |
| Macerich Co | Financials | 24 | 1,091 | 1,130 |
| Sovereign Bancorp Inc | Financials | 55 | 1,182 | 1,113 |
| **Total Other Issues** | | | 99,235 | 93,252 |
| **Heritage Fund's Investment in the External Managers US Small-Mid Cap Pool** | | | **$ 111,304** | **$ 106,645** |

## EXTERNAL MANAGERS EAFE CORE POOL

## SCHEDULE 10

### Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| | | Heritage Fund Share | | |
|---|---|---|---|---|
| Security Name | Country | Shares | Cost | Fair Value |
| Vodafone Group | United Kingdom | 8,946 | $ 29,700 | $ 23,457 |
| ENI | Italy | 956 | 20,248 | 18,735 |
| Total Fina Elf | France | 95 | 21,092 | 17,657 |
| Nestle SA | Switzerland | 58 | 18,925 | 16,856 |
| Glaxosmithkline | United Kingdom | 647 | 24,403 | 16,720 |
| Aventis SA | France | 240 | 22,151 | 15,462 |
| British Petroleum PLC | United Kingdom | 1,499 | 16,827 | 13,960 |
| Novartis AG | Switzerland | 237 | 14,524 | 12,870 |
| Royal Dutch Petroleum | Netherlands | 213 | 15,603 | 12,733 |
| UBS AG | Switzerland | 199 | 15,010 | 12,449 |
| **Total Other Issues** | | | 856,336 | 715,339 |
| **Heritage Fund's Investment in the External Managers EAFE Core Pool** | | | $ 1,054,819 | $ 876,238 |

## EXTERNAL MANAGERS EAFE PLUS POOL

## SCHEDULE 11

### Schedule of Ten Largest Issues (based on fair value)

***March 31, 2003 (thousands)***

| | | Heritage Fund Share | | |
|---|---|---|---|---|
| Security Name | Country | Shares | Cost | Fair Value |
| Vodafone Group | United Kingdom | 3,684 | $ 10,653 | $ 9,660 |
| Takeda Chemical Inds | Japan | 173 | 11,813 | 9,563 |
| Royal Bank Scotia Group | United Kingdom | 277 | 9,800 | 9,152 |
| UBS AG | Switzerland | 136 | 9,575 | 8,499 |
| Glaxosmithkline | United Kingdom | 316 | 11,300 | 8,149 |
| Total Fina Elf | France | 43 | 9,394 | 7,977 |
| Barclays | United Kingdom | 798 | 9,076 | 6,756 |
| HBOS | United Kingdom | 438 | 7,453 | 6,596 |
| Astrazeneca | United Kingdom | 128 | 6,602 | 6,426 |
| HSBC Holdings | United Kingdom | 426 | 7,600 | 6,415 |
| **Total Other Issues** | | | 425,459 | 358,375 |
| **Heritage Fund's Investment in the External Managers EAFE Plus Pool** | | | $ 518,725 | $ 437,568 |

# EXTERNAL MANAGERS EAFE PASSIVE POOL

# SCHEDULE 12

## Schedule of Ten Largest Issues (based on fair value)

***as at March 31, 2003 (thousands)***

| Security Name | Country | Heritage Fund Share | | |
|---|---|---|---|---|
| | | Shares | Cost | Fair Value |
| British Petroleum PLC | United Kingdom | 1,332 | $ 12,562 | $ 12,398 |
| Vodafone Group | United Kingdom | 4,056 | 11,132 | 10,633 |
| Glaxosmithkline | United Kingdom | 358 | 9,877 | 9,255 |
| Novartis AG | Switzerland | 164 | 8,031 | 8,927 |
| HSBC Holdings | United Kingdom | 569 | 7,770 | 8,562 |
| Royal Dutch Petroleum | Netherlands | 126 | 7,744 | 7,523 |
| Total Fina Elf | France | 39 | 7,371 | 7,171 |
| Nestle SA | Switzerland | 24 | 6,615 | 6,893 |
| Nokia (AB) OY | Finland | 287 | 5,516 | 5,826 |
| Royal Bank Scotia Group | United Kingdom | 163 | 4,744 | 5,395 |
| **Total Other Issues** | | | 330,410 | 344,717 |
| **Heritage Fund's Investment in the External Managers EAFE Passive Pool** | | | $ 411,772 | $ 427,300 |

# Glossary

**ABSOLUTE RETURN STRATEGIES**
Absolute Return Strategies encompass a wide variety of investments with the objective of realizing positive returns regardless of the overall market direction. A common feature of many of these strategies is buying undervalued securities and selling short overvalued securities. Some of the major types of strategies include long/short equity, fixed income arbitrage, merger arbitrage, macroeconomic strategies, convertible arbitrate, distressed securities and short selling.

**ACCRUED INTEREST**
Interest income that has been earned but not paid in cash.

**ACTIVE STRATEGIES**
The strategies have two forms - security selection or market timing. Security selection is the buying and selling of securities to earn a return above a market index such as the S&P / TSX Index for Canadian Stocks. Market timing is based on shifting asset class weights to earn a return above that available from maintaining the asset class exposure of the policy asset mix.

**ASSET MIX**
The percentage of an investment fund's assets allocated to major asset classes (for example 60% equities, 5% real estate and 35% fixed income).

**BEAR MARKET**
A market in which prices are declining. A "bear" is a person who expects that the market or the price of a particular security will decline.

**BENCHMARK**
A standard against which others are measured. For the purposes of this report, benchmarks are established income indices used to measure the health of the Fund's investment income.

**BOND/DEBENTURE**
A financial instrument showing a debt where the issuer promises to pay interest and repay the principal by the maturity date.

**BOOK VALUE**
See Cost Value

**BULL MARKET**
A market in which prices are rising. A "bull" is a person who expects that the market or the price of a particular security will rise.

**CAPITAL GAIN**
The market value received on sale of an asset beyond its book value or purchase price. If the asset is bought for $50 and sold for $75, the realized capital gain (profit) is $25.

**COST VALUE**
The value for which an asset was acquired.

**DEPOSITS**
Liquid, short term investments. A cash equivalent.

**DERIVATIVE CONTRACT**
Financial contracts, the value of which is derived from the value of underlying assets, indices, interest rates or currency rates.

**DIVERSIFICATION**
Spreading investment to reduce risk by buying different securities from various companies, businesses, locations and governments.

**DURATION**
A measure of price volatility of fixed income securities (i.e. bonds). It is the weighted average term-to-maturity of the security's cash flows (i.e., interest and principal). The greater the duration of a bond, the greater its percentage price volatility.

**EMERGING MARKET**
An economy in the early stages of development whose markets have sufficient size and liquidity and are receptive to foreign investment. Examples include China, Greece and Brazil.

**EQUITY**
Stocks; the ownership interest in a company.

**EXTERNAL MANAGER**
A third-party firm contracted to provide investment management services.

**FAIR VALUE**
Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value is similar to market value.

**FIXED INCOME SECURITIES**
Interest bearing investments such as bonds and debentures and money market investments such as treasury bills and discount notes (see "Bond" and "Money Market Security").

**GENERAL REVENUE FUND (GRF)**
The central operating account for the Province of Alberta. It is where most of the revenues received by the Province are deposited and from where most of the expenditures are made.

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)**
These are accounting guidelines formulated by the Canadian Institute of Chartered Accountants (CICA) Accounting Standards Committee (ASC), that govern how businesses report their financial statements to the public. They are the principles under which the financial statements of the Heritage Fund and other provincial funds are prepared. These principles help ensure fair presentation of the financial affairs of the Province.

**INTEREST RATE SENSITIVE EQUITY**
Equity whose return is expected to react to changes in interest rates.

**INVESTMENT PORTFOLIO**
A pool of securities held as an investment. Holdings of a diverse group of assets by an individual company or fund.

**LARGE CAP**
Investment in larger capitalized firms. Within Canada, companies with a market capitalization of greater than 0.15% of the total Toronto Stock Exchange market capitalization.

**LIQUIDITY**
The ease with which an asset can be turned into cash and the certainty of the value it will obtain.

**MARKET VALUE**
See fair value

**MARKET (VALUE) RATE OF RETURN**
The market value rate of return measures income (interest and dividends) and capital appreciation or depreciation (realized and unrealized). The method used to calculate the return is the time weighted method.

Time-weighted rates of return are designed to eliminate the effect that the size and timing of cash flows has on the internal rate of return since the pattern of cash flows vary significantly among funds. The investment industry uses time-weighted rates of return when comparing the returns of one fund to another fund or to an index.

**MARKETABLE SECURITY**
An investment for which there is usually a ready market.

**MID-TERM INVESTMENT**
A fixed income instrument (bonds, debentures, treasury bills or discount notes) that matures in one to five years from the date of acquisition.

**MODIFIED DURATION**
Modified duration is the weighted average term to maturity of the security's cash flows (i.e. interest and principal) and is the measure of price volatility; the greater the modified duration of a bond, the greater its percentage price volatility.

**MONEY MARKET SECURITY**
A fixed income security that matures within one year from the date of acquisition.

**NET INCOME**
The amount of earnings remaining after deducting expenses.

**NET INVESTMENT INCOME**
On a cost basis, includes realized capital gains, interest, dividends, security lending income, derivative income and administrative expenses. On a fair value basis, include, in addition to the above, current period changes in unrealized gains and losses.

**NOMINAL RATE OF RETURN**
A measure of return that does not exclude the effect of inflation (see Real Rate of Return).

**PAR VALUE**
A value set as the face or principal amount of a security, typically expressed as multiples of $100 or $1000. Bondholders receive par value for their bonds at maturity.

**PASSIVE STRATEGIES**
These strategies involve investing to replicate the performance of a given market index such as the S&P / TSX Index for Canadian stocks, or managing asset class exposure to match the performance of an established policy asset mix.

**REAL VALUE OR REAL RATE OF RETURN**
A measure of value or return after accounting for inflation. It is equal to the nominal value or return less an amount for inflation.

**REALIZED AND UNREALIZED**
Terms generally used to describe capital gains or losses. A gain or loss is realized when the asset is sold; prior to sale the gain or loss is unrealized and it is only a potential gain or loss.

**SECURITY**
Any investment instrument such as a bond, common stock, deed of trust on property, or any evidence of indebtedness or equity.

**SHORT-TERM INVESTMENT**
An investment with a maturity date of less than one year.

**SMALL CAP**
Investment in smaller capitalized firms. Within Canada, companies with a market capitalization of less than 0.15% of the total Toronto Stock Exchange market capitalization.

**TERM-TO-MATURITY**
The number of years left until a bond matures.

**VOLATILITY**
In financial matters, volatility of returns is the measurement used to define risk. The greater the volatility, the higher the risk.

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**Alberta Heritage Savings Trust Fund Standing Committee**

| | |
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| Deputy Chair: | Richard Magnus, MLA Calgary North Hill |
| Members: | Bill Bonner, MLA Edmonton Glengarry |
| | Dave Broda, MLA Redwater |
| | Debby Carlson, MLA Edmonton Ellerslie |
| | Mel Knight, MLA Grande Prairie-Smoky |
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**Committee Clerk to the Standing Committee**
Karen Sawchuk

**Investment Operations Committee**

| | |
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